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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-121941-08
Date:
October 28, 2008

In Re:

Legend

Settlor	=
Spouse	=
Trustee	=
Trust	=
Marital Trust	=
Residuary Trust	=
Trust 1	=
Son 1	=
Son 2	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
State	=
Statute 1	=
Statute 2	=
Statute 3	=
Statute 4	=
Court	=
Trust 2	=

Dear _____ :

This is in response to a letter dated September 23, 2008, and prior correspondence from your authorized representative, requesting a ruling on the generation-skipping transfer (GST) tax consequences of the termination of a trust.

Facts

On Date 1, Settlor established a revocable trust (Trust) for the benefit of Spouse, Son 1, Son 2, and their spouses and lineal descendants. Trust became irrevocable at Settlor's death on Date 2, a date prior to September 25, 1985.

Upon Settlor's death, Trust was divided into two trusts: a Marital Trust and a Residuary Trust. Marital Trust was equal to one-half of Settlor's gross estate less assets which passed to Spouse outside Trust. The Residuary Trust equals the remaining share of Trust.

Under the terms of Marital Trust, Trustee was to pay all of the net income to Spouse at least quarterly. Trustee was authorized, in its discretion, to pay or expend principal for Spouse's support, maintenance, comfort and welfare. Spouse was given a general power of appointment exercisable during her lifetime or by will to appoint any part of Marital Trust. If Spouse failed to exercise her power of appointment, Marital Trust was to be added to Residuary Trust.

Residuary Trust was to be held in trust for Spouse, during her lifetime. Trustee was to pay all of the net income to Spouse. If the net income was insufficient, the principal could be used for her support. Principal could only be used from the Residuary Trust if principal from Marital Trust was insufficient. Upon the death of Spouse, Residuary Trust shall be divided into two equal trusts – one trust, Trust 1, for the benefit of Son 1 and one trust, Trust 2, for the benefit of Son 2. Trust 1 is the subject of this ruling request.

Under Trust, Trustee will pay all of the net income from Trust 1, at least annually to Son 1 and/or any of Son 1's issue, in such manner as Trustee deems necessary or desirable, in its absolute discretion, for the support and education of such beneficiaries. Trustee of Trust 1 has the power and authority to pay or apply principal of the trust, to the beneficiaries, in such proportions and in such manner as Trustee deems necessary or desirable, in its absolute discretion. Trustee of Trust 1 may also expend principal for one or more beneficiaries to the exclusion of the others. Upon the death of the survivor of Settlor, Spouse, Son 1, and Settlor's daughter-in-law, the principal of Trust 1 is to be distributed as follows: one part to each child of Son 1 and daughter-in-law then living and one part, per stirpes, for the then living issue of a deceased child of Son 1 and daughter-in-law subject to the issue attaining the age of eighteen.

Spouse died testate on Date 3 without exercising her general power of appointment over Marital Trust. Date 3 is after September 25, 1985. Thus, the assets of Marital Trust were added to Residuary Trust and, then, Residuary Trust was divided into two shares, Trust 1 and Trust 2. Spouse's executor filed a Form 706, United States Estate (and Generation-Skipping Tax) Return and allocated all of Spouse's GST exemption to Marital Trust. As a result of such allocation, it is represented that Marital Trust has an inclusion ratio of zero. Accordingly, Trust 1 consists of two portions - one portion from Residuary Trust (nonchapter 13 portion) and one portion from Marital Trust (chapter 13 portion).

Son 1, his wife, and issue petitioned Court to terminate Trust 1. Court entered an order on Date 4 granting the termination of Trust 1 subject to Trustee receiving a favorable ruling from the Internal Revenue Service. It is represented that there have been no additions to Residuary Trust other than the assets of Marital Trust.

You have requested a ruling that the terminating distributions from Trust 1 will not be subject to GST tax.

ISSUE 1

Section 2601 of the Internal Revenue Code imposes a tax on each generation-skipping transfer.

Section 1433(b)(2)(A) of the Tax Reform Act of 1986 (the Act) and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, provide that the generation-skipping transfer tax shall not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. The rule does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12. The transfer is made by the person holding the power at the time the exercise, release or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985. Section 26.2601-1(b)(1)(ii) provides that any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor held a power that would have caused inclusion of the trust in the settlor's gross estate under §§ 2038 or 2042 if the settlor had died on September 25, 1985.

Under § 26.2601-1(b)(1)(iv)(A), if an addition is made after September 25, 1985, to an irrevocable trust that is excluded from chapter 13 under § 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13. If an addition is made, the trust is thereafter deemed to consist of two portions, a portion not subject to chapter 13 (the non-chapter 13 portion) and a portion subject to chapter 13 (the chapter 13 portion), each with a separate inclusion ratio (as defined in § 2642(a)). The non-chapter 13 portion represents the value of the assets of the trust as it existed on September 25,

1985. The applicable fraction (as defined in § 2642(a)(2)) for the non-chapter 13 portion is deemed to be 1 and the inclusion ratio for such portion is zero. The chapter 13 portion of the trust represents the value of all additions made to the trust after September 25, 1985. The inclusion ratio for the chapter 13 portion is determined under § 2642. The regulation further provides that a constructive addition under § 26.2601-1(b)(1)(v) is treated as an addition.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph (b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, but only if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 2632(a)(1) provides that any allocation by an individual of the individual's GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Section 2632(a)(2) provides that the Secretary shall prescribe by forms or regulations the manner in which any allocation referred to in paragraph (1) is to be made.

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property, to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment. Section 2041(b)(2) provides that the lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power.

Section 2642(a)(1) provides, generally, that the inclusion ratio with respect to any property transferred in a GST is the excess of 1 over the "applicable fraction." With respect to a GST that is not a direct skip, § 2642(a)(2) provides that, in general, the applicable fraction is a fraction the numerator of which is the amount of the GST exemption under § 2631 allocated to the trust and the denominator of which is the value of the property transferred to the trust.

Section 2642(b)(2)(A) provides that if property is transferred as a result of the death of the transferor, the value of such property for purposes of § 2642(a) shall be its

value as finally determined for purposes of chapter 11. Section 2642(b) provides that any allocation of exemption to property transferred as a result of the death of the transferor shall be effective on and after the date of the death of the transferor.

Section 2652(a)(1)(A) provides that for purposes of chapter 13, except as provided in § 2653(a), the term “transferor” means in the case of any property subject to the tax imposed by chapter 11, the decedent.

State Statute 1 provides that a noncharitable irrevocable trust may be terminated upon consent of all of the beneficiaries if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust.

State Statute 2 provides that, upon termination of a trust under State Statute 1, the trustees shall distribute the trust property as agreed by the beneficiaries.

State Statute 3 provides, in part, that a court may terminate the trust if, because of circumstances not anticipated by the settlor, termination will further the purposes of the trust.

State Statute 4 provides that upon termination of a trust under State Statute 3, the trustee shall distribute the trust property in a manner consistent with the principles of the trust.

In this case Trust was irrevocable on September 25, 1985. Accordingly, Trust was exempt from GST tax under § 26.2601-1(b)(1)(i). Upon Decedent’s death, Trust was divided into Residuary Trust and Marital Trust. Upon the death of Spouse, Marital Trust was included in Spouse’s gross estate under § 2041(a)(2). Under § 2652(a)(1)(A), Spouse became the transferor for GST tax purposes with respect to Marital Trust. Spouse allocated all of her GST exemption to Marital Trust and it is represented that as a result of such allocation, Marital Trust has an inclusion ratio of zero. Marital Trust assets were added to Residuary Trust upon the death of Spouse. Then, Residuary Trust was divided into two trusts – Trust 1 for the benefit of Son 1 and his issue and Trust 2. Trust 1 consists of two portions – one portion from Residuary Trust (nonchapter 13 portion) which is exempt from GST tax under § 26.601-1(b)(1)(i) and one portion from Marital Trust (chapter 13 portion) which is represented as having an inclusion ratio of zero. Accordingly, based on the facts presented and representations made, we conclude that terminating distributions from Trust 1 pursuant to State Statutes and Court order will not be subject to GST tax.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury

statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Lorraine E. Gardner

Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for § 6110 purposes
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